

5 Things Investors Should Know About New Rules on Money-Market Funds

Brace for the possibility of fluctuating share prices and temporary blocks on redemptions

By
Daisy Maxey
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Investors in money-market funds should prepare now for extensive new rules in mid-October that promise [to fundamentally change the \\$2.7 trillion industry](#), fund managers and experts say.

Under the new rules, prime institutional money-market funds—those that invest in short-term corporate debt and cater to large investors—and institutional municipal money-market funds must allow the value of their shares to fluctuate to reflect the current market price of their underlying holdings.

Prime and retail municipal money-market funds aimed at individual investors will try to continue with a stable \$1 net asset value, but they may impose redemption fees or other selling restrictions during times of crisis.

Government money-market funds for institutional or individual investors will still attempt to maintain a \$1 share price after the rules are in place, and they aren't required to impose redemption fees or suspend redemptions.

The new regulations were passed after the 2008 financial crisis, when [Reserve Primary Fund “broke the buck”](#) due to losses on holdings in Lehman Brothers debt that took the per-share price below \$1, prompting a wave of redemption requests and a government backstop to save the industry. The new rules, in addition to money-fund overhauls put in place in 2010, are meant to reduce the chances of a repeat of that scenario.

Here are five things individual money-market-fund investors should consider ahead of the Oct. 14 implementation:

1. Share Prices May Fluctuate

For many years, money-market funds have kept their share prices fixed at \$1 regardless of what occurred in the market. Yet factors such as interest-rate changes

and market and credit conditions can cause a fund's market-based net asset value to fluctuate above or below \$1.

The implied government guarantee is gone in the new environment, and investors could experience a gain or a loss.

Investors have already pulled billions from prime funds and shifted much of that money into government money-market funds that will still attempt to maintain a \$1 share price after the rule change.

If the notion of a fluctuating net asset value is unsettling, investors who remain in institutional prime funds may want to move their money. But they should consider that, since April, money-market funds have been required to publish daily their per-share net asset values based on market prices. Those disclosures have shown that there has been little fluctuation from \$1.

"It's like watching paint dry," says Peter Crane, president of Crane Data LLC. "\$0.9999 or \$1.0001 is the most fluctuation you'll see."

It will take a disturbance, such as an interest-rate move by the Federal Reserve or a default or a major downgrade of a blue-chip borrower, to create a greater gap, he says. "These minuscule movements ... are not going to cause noticeable losses to investors."

2. Your Money Could Be Locked Up During a Period of Stress

When the new rules go into place, all money-market funds except government funds will be allowed—though not required—to impose a fee of up to 2% on redemptions or temporarily suspend redemptions if a fund's weekly liquid assets fall below 30% of overall assets and its board determines that doing so is in shareholders' best interest.

In addition, all money funds with the exception of government funds will be required to impose a 1% fee on redemptions if their weekly liquid assets fall below 10% at the end of any business day unless a fund's board determines that it isn't in fund shareholders' best interest.

Funds can't suspend redemptions for more than 10 business days in any 90-day period, however.

Concerns about the possibility of these fees and gates are likely responsible for much of the money that is moving from prime funds.

Some fund companies are trying to minimize this possibility. Vanguard Group has increased its money-market funds' liquidity to around 40% of assets, says David Hoffman, a spokesman for the firm. Liquid assets include cash and assets that can be quickly converted to cash, such as direct obligations to the government and receivables scheduled to be paid within one business day.

Government funds aren't subject to these fees and suspensions but could voluntarily opt into them.

One consideration: Investors will likely earn less in a government fund than they would in a prime fund. The yield difference between the two isn't large now, but that will increase if interest rates rise.

3. Your Fund Could Still 'Break the Buck'

Even with the new regulations, retail and government money-market funds will continue to try to maintain a \$1 share price.

While the threat of "breaking the buck," or a fund's shares dipping below \$1, exists, such an event is much less likely now for several reasons. Weaker money managers have exited the business, and rules in 2010 tightened credit-quality standards and imposed new liquidity requirements. Experts say this should give funds more cushion and stability during stressful times.

In addition, regulators will require floating net assets values on the funds used by institutional investors, who've been the most likely to withdraw money in times of crisis. Individual investors in the funds that will try to maintain a steady \$1 share price after the new rules take effect will be less likely to pull their money quickly. In addition, prime retail funds are now much smaller, notes Mr. Crane.

There is a much lower probability that government funds, which invest mostly in cash and government securities, will lose value, but it isn't impossible, says Mr. Crane. If there is ever a problem with a federal home-loan bank, government-sponsored banks that provide liquidity to financial institutions to support housing finance and community investors, assets will likely flood out, he says.

Mike Krasner, managing editor of iMoneyNet, a money-fund information provider, notes that money-market funds are now more transparent than ever. While investors could lose money in a fund, they'll have to weigh that relatively contained risk against the return they'd get in a guaranteed or insured product, such as a certificate of deposit or passbook account, he says.

4. Fund Directors Will Shoulder Weighty New Duties

The new rules place hefty new responsibilities on funds' boards. During periods of extreme market stress, directors will be charged with deciding whether investors can redeem their money and whether they'll pay a fee to do so. Directors will also be responsible for monitoring funds' weekly liquid assets, the possible restructuring or liquidation of funds and the review of enhanced stress tests of funds.

The new duties come as directors are already expressing concern they're being nudged from simply overseeing funds into roles more suited to funds' advisers.

“Clearly they’ve been given more responsibility, and they’ll have to execute those responsibilities in a financial crisis,” says Niels Holch, executive director of the Coalition of Mutual Fund Investors, an advocate for small investors. But Mr. Holch adds he believes directors can perform those duties responsibly.

The new duties don’t represent a fundamental change in the board’s role, says David Smith, executive vice president of the Mutual Fund Directors Forum, which represents independent directors of funds.

5. Fund Companies Now Rate Their Own Holdings

The new rules will also help clarify how money-market funds vet the securities they hold.

In 2015, regulators eliminated a requirement that funds invest only in securities that fall into the top two credit-rating categories of short-term debt or be of comparable quality. Money funds have been required to invest in securities its board or its delegate, such as the fund’s investment adviser, determines present minimal credit risks. But the new rules specify the factors they must consider in their analysis to the extent those factors are appropriate.

The board or its delegate must consider the issuer or guarantor’s financial condition; their sources of liquidity; their ability to react to future events, including their ability to repay debt in a highly adverse situation; and the strength of the issuer’s or guarantor’s industry within the economy and relative to economic trends and their competitive position.

“Definitely, there is more focus on the board of the fund and the fund manager doing their own credit analysis, and not pegging their decision on statements made by credit-rating agencies,” says Mr. Krasner of iMoneyNet.

But there is no restriction on a money fund using information from a ratings firm as part of its determination, he says.

Write to Daisy Maxey at daisy.maxey@wsj.com